IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

IN RE: AMERICAN HOME MORTGAGE HOLDINGS, INC., a Delaware corporation, et al., Debtors.	)	Chapter 11 Case No. 07-11047(CSS) Jointly Administered
DB STRUCTURED PRODUCTS, INC., Appellant, v. AMERICAN HOME MORTGAGE, HOLDINGS, INC., a Delaware corporation, et al., Appellees.	)	C.A. No. 07-00773(JJF)

Thursday, October 16, 2008
11:34 a.m.
Courtroom 4B

844 King Street
Wilmington, Delaware

BEFORE: THE HONORABLE JOSEPH J. FARNAN, JR.
United States District Court Judge

APPEARANCES:

ASHBY & GEDDES
BY: AMANDA M. WINFREE, ESQ.

-and-

BINGHAM McCUTCHEN, LLP
BY: STEVEN WILAMOWSKY, ESQ.

Counsel for the Appellant

APPEARANCES CONTINUED:

YOUNG, CONAWAY, STARGATT & TAYLOR, LLP
BY: PATRICK A. JACKSON, ESQ.
BY: ROBERT S. BRADY, ESQ.

Counsel for the Appellee

THE CLERK: All rise.

THE COURT: Be seated, please, and good morning.

All right. Ready to proceed?

You want to announce your appearances?

MS. WINFREE: Good morning, Your Honor. I'm Amanda Winfree from Ashby & Geddes on behalf of the appellant.

With me in the courtroom today is Steve Wilamowsky of the firm of Bingham McCutchen.

THE COURT: Okay. Thank you.

MR. WILAMOWSKY: Good morning, Your Honor.

THE COURT: Good morning.

MR. JACKSON: Good morning, Your Honor. Patrick Jackson from Young, Conaway, Stargatt & Taylor on behalf of the appellee, American Home Mortgage and their affiliated Debtors and Debtor-in-possession.

And with me is Mr. Bob Brady from our office.

THE COURT: Good morning. All

right.

Are you ready to begin?

MR. WILAMOWSKY: Yes, Your Honor.

THE COURT: I have kind of focused on the 361 question -- 363 question with regard to the bankruptcy judge's conclusions, and also subsumed into that -- you know, subsumed into that the question of the applicability of the integrated case. So if you want to focus there, it might be more helpful in the limited time we have.

MR. WILAMOWSKY: Absolutely, Your Honor. I'd like to focus wherever I can be helpful.

So I can skip right to that discussion. That would be fine.

Your Honor, with respect to 363, I assume that Your Honor is referring to the bankruptcy judge's conclusion or the issue as to what the Bankruptcy Court concludes as to whether, in fact, this is an agreement that arises or an agreement that is subject, if it's going to be transferred subject to the provisions that permit transfer under 363 rather than under

365 of the Bankruptcy Code.

THE COURT: And the redundancy that you argued of 365 -- well, tell me what your position is, because that's what I want to get clear.

MR. WILAMOWSKY: Okay. Your Honor, we were very clear, I think from the outset, and especially once we filed the briefs, we think that whether the analysis is -- whether this is an agreement under 363 or whether it's an agreement under 365, we think that there is -- frankly, we think we win either way.

But once the Debtor took the position that this was an agreement under 363, we essentially said, Fine. Have it your way. We basically said that in the brief. We said, We're not going to challenge that position, because we think we win either way.

So if the Debtor wants to take the position that this is an agreement under 363, that's a position that we're perfectly willing to adopt.

The Debtor has argued, and we have not challenged it -- the Debtor has argued, Look,

this is an agreement where there is no performance required on the side of our client, the appellant. DB is not required to do anything.

The loans are there. DB Structure Products. They serviced and we're required to receive a fee.

There's no recourse to Structure Products for anything. So the Debtors' position, and seemingly the position that the Bankruptcy Courts adopted as well in the absence of any opposition from us, was this is an agreement that, if it's going to be transferred, has to be transferred under Section 363 of the Bankruptcy Code.

Your Honor, 363, there is only one restriction that can be found anywhere in Section 363 -- or one exception. Let's put it that way.

There's only one exception in Section 363 that can be found anywhere that would say that, notwithstanding whatever the Debtors' right would be under state law, the supremacy clause in the Bankruptcy Court working -- Bankruptcy Code working to create a different

result than would prevail under state law.

And that the only such section in that regard is Section 363L of the Bankruptcy Code. 363L of the Bankruptcy Code deals with what we conclusory refer to in the bankruptcy bar as ipso facto clauses.

It's -- colloquially, it's if you have an agreement that says that it will terminate or the rights of the parties are somehow -- are modified in any way, or at least in any material way as a result of the financial condition of the Debtor, or the insolvency of the Debtor, then that provision can be overrode.

That condition -- that provision can be overridden, and the agreement could be sold, transferred, whatever, notwithstanding that provision that may be contained in the agreement.

In all other respects, Section 363 is simply an enabling statute. It permits the trustee, the bankruptcy trustee, or in the case of a Chapter 11 case, the Debtor-in-possession to transfer whatever right it has with whatever burdens are attended. And those cannot -- those cannot be modified in any way.

Your Honor, we think that it's clear that this is what Integrated dealt with. And we think, in fact, that it's directly on point.

Integrated was a case where a trustee, under state law, under applicable state law would not have been able to sell the assets that he was trying to sell due to state law restrictions on the sale of tort claims. And the trustee tried to say, Well, that's a restriction on my ability to sell under Section 363.

The goal is I should be able to sell these assets to maximize the benefit for the estate. And Your Honor, Integrated said that -- the Third Circuit said in the Integrated case, No, Section 363 is an enabling statute.

Moreover, the Third Circuit said Congress knows how to create exceptions when it wants to. Look what it did, it created Section 363L.

So by saying that, the Third Circuit actually recognized -- acknowledged the existence of 363L. And at the same time, said 363L is not a catchall.

Congress knew how to create an

exception when it wanted to do it and created Section 363L. That completely undercuts any argument, in our view, that the Debtors would want to make to somehow broaden the scope of 363L beyond what the words would allow.

So as to call anything that hinders the Debtors' ability to get the most dollars that any buyer would potentially pay for any particular bundle of rights within an agreement, anything that hinders that would be considered an ipso facto under 363L.

We think that Integrated case is very clear that you can't read 363L that way. And the Integrated Court has essentially said that.

Moreover, if you look at the background on 363L and on the Integrated case, as we note in our briefs, there's a long history that predates the Bankruptcy Code with respect to this issue. And that is -- and what the Bankruptcy Code effectively did was to codify the Supreme Court case of Chicago Board of Trade v. Johnson.

In that case, the trustee, or

whoever it was in bankruptcy, wanted to sell a seat that the Debtor held on the Chicago Board of Trade on the Chicago Exchange. And it was believed to have substantial value, could have brought in value through the estate.

However, there was one problem under the governing agreements --

THE COURT: Well, that's a 1924 case. I understand it's a Supreme Court case. I understand that there was some debt payment attached to the transfer.

MR. WILAMOWSKY: Correct.

THE COURT: You want me, in reviewing this in a de novo fashion, to basically say that the bankruptcy judge's conclusions about 363 and the application -- well, what the Debtor says is, Listen, you're going to get a stream of money, so what are you complaining about? Unlike when you have anti-assignment provisions, typically like in a lease context.

MR. WILAMOWSKY: Right. Well, we're not --

THE COURT: I'm just trying to understand your argument. They're getting a

stream of money. They're selling the stream of service and payments. They're selling the stream of money.

MR. WILAMOWSKY: Right.

THE COURT: And where's your harm by the way that bankruptcy judge treated the agreement?

MR. WILAMOWSKY: The harm is very pronounced. In fact, in current market, Your Honor, the harm is that it is exceedingly difficult to sell loan portfolios in last year's market when this first came up, you know, when we were dealing with this case. But much, much harder in this market to sell the loan portfolio.

And when you're trying to sell the loan portfolio on a basis where you can't give the party the full bundle of the rights, you can't give the party the whole loans, and they're still --

THE COURT: Tell me how that works a little more, because that's maybe the part I don't get, how that works.

MR. WILAMOWSKY: There is a -- there the master loan, MLPSA, what we call it, was

entered into by other parties. There are provisions in dealing with servicing, with sale of a loan, with breach of warranties, with all the various things. There's a waterfall provision that tells the servicer how to apply fees.

All of that governs the treatment of these loans. What the agreement, however, also provides is that there are requirements that both the seller and the servicer have obligated themself to, both contracting Debtors. Not only to service the loans properly, but also to maintain certain approvals to maintain certain qualifications with Fannie Mae, with Freddy Mack to buy back loans that were originated, that went in default in the first three months.

All of those are encapsulated within the agreement and are part of the waterfall provision that is contained in the agreement that, pursuant to which when the servicer gets in money, here's what I have to do with it. And all that is wrapped into this agreement.

And what the Court has done, what the Bankruptcy Court has done by effectively

rendering them into two parts, based solely on where -- you know, where it would be beneficial to the Debtors and where the liability will get left behind in the estate, and where the buyer will be able to get a benefit is create a situation where you've got a servicer.

But the servicer is somehow providing or applying payments in a quasi contractual way, because there's nothing in the agreement. The contract has effectively been reformed or something. There's no real -- the application of the servicing doesn't -- of the fees that come in, not being done pursuant to any writing, any agreement that anyone can point to, because the waterfall provisions are being violated.

The indemnity provision -- it's not clear where -- you know, which ones "relate to service" and which ones relate to sale. It's never been analyzed. And it's never been broken apart that way.

Presumably that would be a litigable condition some day. You know, you're going into a very, very difficult market and you're saying,

Here's this agreement, but I can't really sell you all the loans. I'm selling you the loans that arise under this agreement, but it's not exactly this agreement. There's other things that are being -- you know, that have been written out of this agreement by the Bankruptcy Court. I can't tell you exactly what those are.

That's not what we negotiated for, Your Honor. We negotiated for a single agreement where the seller and the servicer would be both on the hook.

They both agreed to be on the hook where there would be a specific stream of payments that would be applied in a particular way. And one of those things was that if there is any payments due for early payment defaults, breaches of warranties, that those would be held back, and the debt -- the servicer would not be able to receive its servicing fee until those were satisfied.

And that's been completely written out of this agreement. We have not gotten the benefit of our bargain.

As we said, we have argued Fleming

is not applicable here, because it's a 363 based on the Bankruptcy Court's decision that it's a 363-type agreement.

But to the extent that Fleming would be relevant and it's a 365 agreement, you think of it in those terms. There's a two-prong inquiry that the Debtors concede exists under Fleming.

One of them is materiality. The other one is economic significance.

The Debtors treat that almost as if it's all in one. It's not all in one, because it's really -- if one looks at Fleming, it really -- the difference between the two is that one goes to what was material at the time it was negotiated. The other goes to what's economically significant now.

Both of those tests have to be passed. In other words, it has to be -- in order for the Court to ignore the provision, it's got to both be a provision that wasn't material at the time it was entered and not of economic significance now such that the party gets the benefit of the bargain.

But you can't -- what you can't do is you can't come back and say, We think the Court did and said, Well, you know, the agreement said you negotiated for Freddie Mac qualifications. We agree that Freddie Mac qualifications was something you negotiated for at the time, but as a factual matter, we have testimony to show that even if the Debtors are not Freddie Mac qualified, they've been doing a great job servicing. And Freddie Mac has effectively negotiated that for the purpose of trying to keep an eye on the servicing and making sure that certain standards were maintained.

You've got those standards now. So in retrospect, you didn't need the Freddy Mack.

That's the kind of Monday morning quarterbacking that we respectfully submit Fleming absolutely does not permit. In any event, we say Fleming -- it relates to a 365 analysis. So it doesn't really apply here.

The other point I would make, Your Honor, is that under the section that the Debtors focus their brief on, the question of the contract visibility under New York law, and

accuse the appellants of focusing the Court on the 363 issue to the -- to the detriment of, what it calls, a central issue is the issue of visibility.

It's very important to note, however, that you don't get into the question of the visibility under New York law unless you can conclude that the 365 applies.

If you cannot conclude that Section 365 applies, there is no "cross default rule". And, therefore, even if you can somehow find a basis for dividing the contract under New York law, it doesn't help you, because you've still got -- on the servicing side, you've still got the waterfall provisions that hold back certain payments based on breaches of warranties.

You've still got the indemnification provisions. So if you don't have 365, and it's a cross default rule to rely on, then if -- even if you can divide the contracts under New York law, but if it's a 363-type agreement, it's a futile exercise, because you're still in a situation where the Debtors are in -- where the servicing piece that you've just -- that you've just broken

it out into is one that the buyer would have no interest in.

So it is essential and it is a -- the central point as to the point that the Debtors standing up here today cannot argue in front of Your Honor that this is an executory contract, because they spent the last number of months before the Bankruptcy Court last year arguing that this is not an executory contract.

So for that reason, we don't think that the Debtors have any basis to defend this appeal.

And then, finally, Your Honor, I would note --

THE COURT: So your harm -- to get back to the question --

MR. WILAMOWSKY: Right.

THE COURT: -- is the marketplace?

MR. WILAMOWSKY: The harm is -- well, the market. Obviously, the market is -- yes, the market is causing the harm.

The fundamental harm is that we're not getting the benefit of our bargain. I mean, that's the harm.

We're still sitting on these agreements. We can't sell them.

We're still holding them. Structure Products -- and the testimony was uncontroverted on this point -- it was not in the business of holding loans.

Structure Products would in this -- whenever everybody was having a party with the securitizations, these would -- you know, Structure Products would structure these and would sell them. It is a market now where you can't really sell.

THE COURT: And affected by this decision and the sale order, what is the volume?

MR. WILAMOWSKY: Oh, in terms of -- in terms of what the purchaser would be willing to pay for? The purchaser is willing to pay, I believe, one -- about one and a half million dollars probably at this point. Because probably worked down -- it's about one and a half million dollars from what the purchaser has agreed to pay in a transaction of this size of, what was it, about $400 million, something like that?

So it was -- you know, we don't

think that affects the legal analysis. But for whatever your -- for whatever it's worth, it's a small percentage of the total transaction, which has already closed, has already consummated. The sale has already occurred.

And apparently the Debtors have negotiated an extension with the buyer pursuant to which the buyer, if the Debtors can get them a final order by a date certain, the buyer will be obligated to purchase these agreements.

But Your Honor, in our view, the key is 363 does not allow the Debtor to try to divide the contract this way. If it wants to assign the agreement, it's got to sign it with the burden. Everybody -- everyone agrees that the agreement with the burden is not something the buyer is interested in, and therefore, is fundamentally not of value.

The Debtors say we want to get the intrinsic value out of the agreement. There is no intrinsic value, because on a net basis, there's just no balance value.

It's illusory to say this has got intrinsic value, because I'm looking at a

particular right that I have under the agreement without looking at all the various obligations.

Your Honor, to the extent that I have a few more minutes, I'd rather save them for brief reply.

THE COURT: All right. Thank you.

MR. JACKSON: Hi, Your Honor. Again, Patrick Jackson, Young, Conaway, Stargatt & Taylor.

I can pick up on the Integrated issue, but I'd actually like to walk through some aspects of the MLPSA of the underlying agreement here, because I'd have to disagree with some of what counsel has said and how counsel has described the way that the agreement works.

Your Honor asked what's the harm? And we actually see that as the central issue here.

The record doesn't show that there is any harm resulting to Structure Products as a result of the sale. Now, the harm that they've articulated -- that they articulated at the trial was that their EPD and their premium recapture claims would not be paid.

This was something that their witness acknowledged on cross-examination, and we note this in our papers. That in the absence of a bankruptcy, had Structure Products been permitted to terminate its servicing rights, any successor servicer that they would have selected would not have picked up the EPD and premium recapture obligations.

So whether they're selling under bankruptcy or whether we're allowing them to allow their rights outside of bankruptcy, there's no difference as far as they're concerned. They have a claim against the bankruptcy estate for the EPD and premium recapture obligations.

And that's the same under either scenario. So the harm -- that's the harm that they explored at the trial.

Now, the harm that you've just heard from counsel --

THE COURT: And that will be available to them?

MR. JACKSON: A claim we -- actually the plan of liquidation in its current form actually has a protocol for dealing with EPD-type

claims. And then premium recapture claims are just assertable as a claim as any other unsecured claim against the estate.

And that's important to note that the Bankruptcy Court was not extinguishing the right to payment. It was just directing the right to payment to rest against the Debtors.

I understand, for practical purposes, because claims against a liquidating estate is not -- you know, not worth what the dollar for dollar that they would want. That's understandable.

But I just wanted to emphasize that there was no indication on the record below, and actually they admitted otherwise, that there's no way that they're going to get these paid in full, whether they're in bankruptcy or not.

So that can't be the element of the harm that was caused to them by the result of the sale.

Now, what you heard from counsel was that the harm is that it's difficult to sell a loan portfolio when you can't sell the whole loan. When you have to sell the loan, but the

servicing rights reside elsewhere.

And you know, hearing that, I'm really glad that we -- that we counter designated for the record on appeal the record of the proceedings before the Bankruptcy Court very early on in the case where Structure Products moved for relief from the automatic stay to permit them to terminate the servicing rights.

Now, at the time of that, they moved under a theory that the MLPSA was an executory contract. They sought relief from the automatic stay to terminate the contract on the basis, among other bases, that because there was the -- at the time, there was the Fannie Mae -- lack of Fannie Mae qualifications.

They asserted that this was an incurable default that would preclude assumption and assignment of the MLPSA in any sale.

And they also provided that the lack of Fannie Mae qualifications, Fannie Mae at the time, not Freddie Mac, would render it impossible for the Debtors to provide adequate assurance of future performance.

Now, cure and adequate assurance are

both uniquely 365 concepts under the Bankruptcy Code. So I'd note from a very early position, they were asserting as a basis for getting the loans back that it would be impossible for the Debtors to satisfy a 365 standard. And we pointed this out in our papers.

Now, at this hearing, the Bankruptcy Court on the hearing on the stay relief motion, the Bankruptcy Court, once the Debtors had provided evidence that the Fannie Mae situation had, in fact, been resolved and that Fannie Mae qualifications had been temporarily restored, the Court asked of Structure Products, what's the harm then to denying the stay relief motion and letting the Debtors see if they can sell this thing?

And at the time, the argument was, Well, we can't sell these loans because the servicing is tied up. Now, on the record of the stay relief hearing, the Debtors -- you'll see there was testimony of Mr. Principato from Structure Products who also testified at the sale hearing. He said, "I can't sell these loans and I can't sell them because of the Fannie Mae

issue."

The Debtors put on evidence, testimony of Simon Sakamoto, an employee of the Debtors, who testified that the nature of the Structure Products' loan portfolio were international taxpayer identification number loans. These are loans to undocumented immigrants.

And that ITIN loans, as they're known, are not agency eligible. They may not be purchased by Fannie or Freddie, which makes sense in light of their federal government charters. And, furthermore, to the Debtors' witness' knowledge, it was not possible to securitize ITIN loans in a private-label securitization transaction, because one of the predicates to a private label is securitization.

You have to get a bond rating agency, such as Moody's or S & P to rate the pool of loans before you can dump it into the securitization. And the Debtors had actually tried, and Mr. Sakamoto testified that the Debtors had, in years past, attempted to get Moody's to rate ITIN loans. And the results

hadn't been fruitful.

So the testimony of the Debtors' witness was, Well, if you can't sell these loans or securitize these loans, it's not because of the lack of Fannie qualifications. It's because the nature of the loans.

They're ITIN loans. These are not susceptible of securitization.

And there was no evidence presented to rebut this. And Judge Sontchi denied the stay relief motion without prejudice for their ability to bring it back at a later time.

But I think it's really instructive here to see that, you know, we're going over the same ground that we've tread before. And as far as the sale hearing goes, there's no evidence on the record of the sale hearing indicating that there is any impairment of their ability to alienate this mortgage loan pool.

Now, to get to the MLPSA on this point, the actual contract, I note that the MLPSA itself contemplates that Structure Products would sell the loans on a whole-loan basis. I don't have the agreement in front of me right now, but

it was -- this is Record Item 37. And it's Pages 40 to 41, Section 1269.

MLPSA talks about the various ways in which the parties acknowledge that the loans that are being serviced pursuant to this agreement may be placed into a securitization. They may be sold on a whole-loan basis, which would terminate the servicing binary of the whole loan transaction.

And Section 15 of the MLPSA, which is Page 59 of the agreement, which by nature actually is a termination provision. And it expressly permits -- as is done in these transactions, it expressly permits Structure Products to terminate the Debtors' servicing right with or without cause.

The only catch is that if Structure Products terminates its servicing right without cause, they have to pay this servicer their market value of the servicing right. So ordinarily how this would work is if Structure Products lines up a whole-loan trade and it wouldn't move the loans along with the servicing right, that's fine. They will just take some of

those sale proceeds. They'll pay the service -- the value of the servicing strip, and everything will be fine.

Nothing under the MLPSA precludes them from selling and terminating without cause and paying the fair market value of the servicing right. And nothing in the sale order -- and I mean, I'm willing to represent on the record here, nothing in the sale order precludes operation of this termination provision.

This is not one of the things that the Bankruptcy Court excised from the contract. And this is something that they've been able to -- they still are able to exercise this right vis-a-vis the purchaser.

So the idea that they're suffering from harm as a result of the inability to alienate the loans, it's just not supported on the record, either the factual record or the actual agreement itself.

Now, to go to -- pardon me, Your Honor.

I guess I can go to the Integrated Holdings, Your Honor. Now, we -- in our papers,

we raised what we consider a threshold issue of before the Court -- before this Court can reach the issue of whether the Bankruptcy Court's misapplication of the Integrated precedent or misapplication of 363L to invalidate the anti-assignment provision, before the Court can get there, the Court has to conclude that the appellant can even raise this issue.

I think it's interesting to note that in counsel's argument, he said that the Debtors today are precluded from arguing that the MLPSA is executory and subject to 365, because we've spent the last year arguing that it wasn't. And I mean, that's -- to flip that around, that's precisely the point that we've made in our answering brief is that the appellant is estopped, is judicially estopped from now saying oh, it's non-executory, because it's non-executory.

The only way the Bankruptcy Court could have authorized the sale is under 363. And because there was a 363 error of law, you should, therefore, reverse the sale order.

Now, we pointed out in our papers

that in light of the fact that the Court did not decide whether the agreement was executory or not, because presumably the Court thought this was a live issue between the parties at the time, that it took the decision under advisement. Because the Court didn't decide that.

In order to conclude that an error under 363, whether as a result of the Integrated precedent or not, is grounds to reverse the sale order, the Court would either have to find that the MLPSA is not non-executory or remand for the Bankruptcy Court to figure that out.

And in the same way as counsel suggests that the Debtors would be precluded from arguing that it's executory at this point, they are precluded -- we -- our position is they're precluded from arguing that it's not executory.

I mean, we had -- as I mentioned just a moment ago, we had an evidentiary hearing very early in the case on stay relief. The theory advanced at the stay relief hearing was it would be futile to allow the Debtors to continue to exercise these servicing rights, because there's no way that they could sell them because

they cannot meet the standards of 365.

This position was advanced and we go through this history, the history of the development of the appellant's position below pretty exhaustively in our answering brief.

This position was advanced and readvanced and readvanced. There were further defects in the proposed sale of the servicing agreement based on the various requirements of 365.

Cure of prior defaults required under 365, not under 363. Adequate assurance of future performance, again required under 365, not under 363.

And it was really only when the Debtors came out with their brief and in support of the sale, which I note was drafted in response to in excess of 30 objections, and addressed a pool of servicing agreements that covered 180 agreements or so.

It was only in response to the Debtors who then advanced a differential theory under both -- that theory under both that DB began to think, Oh, let's address the 363 issue

as well.

And I understand that they needed to do that. But the way that they did it was not to say, you know what, Debtors, you're right. We've been wrong all along. We agree with you. 363 applies. Now, let's talk about Integrated.

They didn't say that in their initial -- in their reply brief. They said, Well, we don't think that's a very good idea that this is -- that this is governed by 363. We're going to still advance some of our 365 arguments. But to the extent, you know, we lose on this issue, here's some 363 arguments.

Integrated wasn't even mentioned in that brief. Integrated didn't even come up in oral argument. That's fine.

I understand that adequately preserves the Integrated decision for appeal. But it's interesting to note that it didn't really become the crown jewel of the appellant's legal position until after the sale order was entered, and presumably after some additional research was done.

And then they said, ah-ha, this is

what we should have been arguing all along. So now let's say --

THE COURT: That's kind of like the pattern in bankruptcy. You have all the presentations. Judge Sontchi's analysis of the separability of the agreements and permitting the sale.

I don't have that familiarity with his record. Did he ever address this issue?

MR. JACKSON: The Integrated decision?

THE COURT: Yeah.

MR. JACKSON: Not at the sale hearing. And actually where this all comes from is if you read his decision specifically on the DB agreement, which was reserved for the very end of his bench ruling, his very long bench ruling, and he addressed the DB structure, the UBS and Morgan Stanley agreements together, presumably because each of them had disagreed with the Debtors' non-executory theory.

He actually did all of his analysis. And as they correctly point out in their papers, all of his analysis centered around the Shaw

Group case, the cross default rule. I think there's mention of Fleming.

These were all 365 precedents. Now, we, you know, don't believe they're necessarily limited to the 365 context, but if you read his decision, it actually reads as if he's responding to all of the 365-based arguments that all of those objecting parties had raised in their papers up until that point.

And it was only in one sentence of his ruling where he says, Therefore, I can conclude that the indemnity waterfall and termination provisions of the MLPSA's constitute the ipso facto assignments, which are unenforceable under 365F and 363L. And alternatively, 363L.

He didn't understand the holding, though. Now, it had come up in oral argument earlier that counsel had raised the Integrated decision. And we had responded that to the extent the termination provision and the cross indemnity provision, to the extent that all of these things -- the purpose of these provisions was to allow Structure Products to hedge against

the financial ruin of the Debtors, that these could be constituted ipso -- these could constitute ipso facto provisions subject to 363L.

And actually in this connection, Your Honor, I just wanted to highlight, Mr. Principato from Structure Products testified that the purpose of these, the indemnity default waterfall provision, this was based on -- his testimony was -- that the failure of the seller or the servicer to make an EPD or recapture claim would be an indicator that the Debtors' business enterprise was in financial distress.

So it would make sense that they would want the ability to terminate servicing. And that's really what we were basing that argument on below.

The judge didn't really address it in his opinion. He just said in his ultimate ruling, alternatively 363L invalidates these provisions. But all of his analysis was based -- tied very closely to the Shaw Group opinion, which was actually decided under 363 and 365.

The recapture claim, which I can talk about for a moment, if you'd like, but it

was focused very closely on the 365 half. So, if anything, it looks as if what the judge was doing was being responsive to what the objectors had been asserting, that there were these elements of 365 that could not be satisfied, and therefore, he precluded the sale.

And then, you know, kind of as a last thought, he threw in a knot to the Debtors' alternative theory. And he figured I've made everybody happy, so I don't need to decide the underlying issue if I think the result would be the same both ways. So I won't.

Now, after this, I think that's when the appellants really reconsidered the strategy and said, ah-ha, you know, there's not a whole lot of case law on 363L, and you know, it's counterintuitive. And we can make a lot out of this, so let's -- you know, I think it's a bit revisionous to say, Let's say that we've conceded the point that it's not executory. Let's switch horses, and let's go that route on appeal.

I think that's what they've done. And I -- the reason that I think that's problematic is, like I said, in order to conclude

that the sale order would be reversed as an error under 363, the Court would have to find that it's non-executory. But in order to do that, this Court would either have to find it or would have to remand it to Bankruptcy Court to find it.

And that would put you in a really awkward position, because it would put them in the position of arguing exactly the opposite of what they had been advancing all the way up until the last day of the sale hearing. And even then, it wasn't as if they had fully adopted the position, because they were still advancing their alternative theories.

And I think that's -- I really think that's an inappropriate place to use the doctrine of judicial estoppel just to say, Look, you know, you asked the Bankruptcy Court for a 365 ruling. You got it.

It was perfectly ripe for appeal. I will acknowledge that.

I mean, it was a matter of first impression, whether a servicing agreement could be severed from an MLPSA. It's not something that there's conclusive, you know, guidance from

the Third Circuit on. It's something the Bankruptcy Court himself noted was a close call.

Why would you not appeal the 365 ruling that you asked for?

THE COURT: A lot of the Second Circuit law on whether service agreements are discernable, there's Judge Chanci's subject appeal in the Calion decision -- I think in this circuit, it's unresolved. And as an appellate court, which is how we sit now in the Third Circuit, will sit -- there's some predicate questions that probably would require remand where, I think in some of the bankruptcies being dealt with in the Second Circuit -- I don't know.

But --

MR. JACKSON: Right.

THE COURT: What's the status of the estate today?

MR. JACKSON: In terms of progression towards a plan and such?

THE COURT: Yeah.

MR. JACKSON: The estate, the Debtors have filed a plan back in mid-August. They've amended the plan a couple of times.

And most recently there was a motion to appoint an Official Committee of Borrowers, which the Bankruptcy Court granted. We had originally been on track for confirmation hearing in about mid-November, but in light of the Court's decision to appoint a Committee of Borrowers to consult in connection with negotiation of the plan, it's likely that confirmation will be deferred until December or January. But there's a plan on file. Disclosure statement on file.

It's a liquidating plan. None of the Debtors are going to be reorganizing. It's a very slim recovery base. On our estimate now, anywhere from .1 cent to six cents, depending on which estate the claim is against.

So that's the general status of the case.

THE COURT: And if there is reversal of this decision with regard to sale of the servicing arm, there's some diminishing scale value going on?

MR. JACKSON: It would be -- it would not threaten the sale as a whole. It would

just be this piece, this particular subgroup of loans and the servicing right related thereto.

So, as counsel indicated, it would be -- it would represent approximately $1.5 million of additional value that would come into the estate if a final order were entered. And if the sale order were reversed, then the purchaser would be able to exercise rights under the Asset Purchase Agreement, not to -- you know, to walk away and actually would be precluded, as a matter of law, of trying to buy them at that point.

And the servicing right, and the MLPSA's, and the whole kit and caboodle, if you will, would revest in the Debtors. And then we would be -- I'm not sure where we would be.

The Debtors would be holding -- would still hold the servicing right and presumably could seek to sell them as part of the -- along with the entire MLPSA. That wouldn't be likely based on the magnitude of the claims that they're asserting.

So I would think as, for practical purposes, it would just be -- you know, the Debtors' estate would be out about $1.5 billion

dollars that would have, otherwise, gone to satisfy their pre-prepetition secured creditors.

Now, you know, there's -- certainly there's no mootness argument to make in a live issue. It's not as if this appeal is going to alter the state of the case is what I'm getting at.

But I think I agree with you that a remand would be appropriate on the issue of executory versus non-executory. And I guess the point I'm making is that --

THE COURT: Well, if you thought you had to get to that and you find another ground to affirm --

MR. JACKSON: Right. Right. And actually speaking of --

THE COURT: And maybe, you know, if it got to the Third Circuit, they may not see the need to remand. They may feel that under their appellate authority --

MR. JACKSON: Correct. As Your Honor could do as well, based on -- I mean, I think the record is plenty on a matter of points if some of the nuances of the arguments that have

been raised on appeal weren't necessarily dealt with below and the court's ruling -- the Court's kind of limited ruling.

But I know I've gone on for some time, Your Honor. I can address the Integrated decision if you'd like me to. But other than that, I don't want to take up too much time.

THE COURT: No. I think we're good.

Let's have a rebuttal. And I think we have a better understanding.

MR. WILAMOWSKY: Terrific.

THE COURT: Thank you.

MR. WILAMOWSKY: Thank you, Your Honor. I'll try to keep it under five minutes.

First of all, I think that Mr. Jackson did an excellent job in terms of really articulating, better than I could have thought of without him, my client's harm. Because what he said, which was -- I like the way he said it, is our client is in a position -- my client is in a position to terminate the servicing agreement if it wants, pursuant to the -- without cause, pursuant to those provisions of the agreement that allow you to terminate without

cause and make certain payments in order to effect that termination without cause.

So really a good way of describing the harm here is that there is cause. So, what's the Debtors' harm? That we have -- they've got grounds to terminate the servicing agreement for cause. And the Debtors are trying to force us into it for no cause provisions, which has a significant cost attended to that.

So, I mean, you could describe it -- the reason I described it as the market cost the way I did is because, yes, it's true that the real cost is the $18 million that we are asserting in DB's claim that we wouldn't get. That's particularly the cost as sort of a Chicago Board of Trade Creditors case.

Well, what is the harm to the other creditors if the seat goes to somebody else? What do they care if the seat goes to somebody else?

Well, they care because they've got a contractual right to money that they're now going to get a penny on the dollar, whatever I'm going to get on the case, too. A Penny on the

dollar. They have got a right to be paid if the seat is going to be taken.

It's not the right that's the harm, per se. It's the ignoring of the rights that are associated with that agreement.

So, yes, we can terminate without cause, but there is cause. And, therefore, you know, that's a harm that we shouldn't have to sustain.

As a practical matter -- like I said, as a practical matter, it's the market cost. And the reason I said it that way is because, as a practical matter, we're not going to get $18 million if Your Honor reverses Judge Sontchi's ruling, because they're going to probably go ahead and reject -- it's almost certain that they're going to reject the agreement if they're faced with the choice of assuming it in toto or rejecting it in toto.

Therefore, if they reject, we'll have effectively -- what we'll have is our loan back. So the practical and immediate harm is the fact that we don't have our loans back. And if Your Honor reverses, we would get our loans back.

But, theoretically, it's the $18 million claim that we're not getting paid in the same way as the Chicago Board of Trade Creditors were not getting paid in that case.

I would also note just to correct a few matters of the record is that on the ITIN, what Mr. Jackson refers to as the ITIN loans to -- again, that is to us Monday morning quarterbacking, because ITIN loans were not the only loans that were presumed were going to be purchased under this agreement.

And, in fact, were not. They were most of the loans, but there was a minority of the loans that were not these ITIN loans.

And the record reflects that in the proceedings below. But Mr. Jackson is saying, well, since most of the ones that ended up getting purchased were ITIN loans any way and may have had a hard time being part of securitization, you really didn't need Freddie Mac too much.

We think that Fleming precluded that, because Fleming looks at materiality. The benefit of the bargain and the -- what did the

parties bargain for in the first instance, not in hindsight. It was a material term in the first instance.

Also, with respect to materiality, it's the same point under New York law. And in the Debtors' brief, the Debtor said, Well, Freddie Mac was not material because they were doing a good job servicing. Well, New York law defines materiality as a material time term as the time that the party bargained for it such that they wouldn't have entered into that agreement without that term in the agreement.

Again, an ex ante standard, not a post facto standard that the Debtors are trying to impose.

And, again -- then, finally, Your Honor, with respect to the estoppel arguments, I mean, we've addressed it amply, I think, in our reply briefs. I am not going to take up too much more time except to point out, obviously, first, the first rule of judicial estoppel is, well, we lost. So even if we were coming in and we had raised the lift stay, and even if we had come and made a lift stay motion, and if we had won on the

basis of 365, which by the way, we could have won on either basis, because the Debtor has -- the Debtors allege in the papers, et cetera, commensurate 363 or 365.

So if there was an incurable default, that could have been caused by lifting a stay, whether it's 365 or 363. But let's even assume the Debtors are right. Let's assume that we are right that 365 would have been our basis for getting stay relief.

We didn't get stay relief, so we got no benefit from taking a position. And now we're trying to take a contraposition. We lost.

Well, parties frequently take positions, lose. The Court finds something else. And then within the Court's finding, the parties have to work with -- the party has to work within that framework of what the Court has found, as a matter of fact, to try to address the arguments in that framework.

So there is no judicial estoppel where we lost. And if Your Honor has any questions, I'd be happy to answer them.

But, otherwise, I would commend Your

Honor's attention to our -- particularly to our reply brief. And thank you for the honor of appearing before you today.

THE COURT: Thank you.

I am going to ask you each a question, same question and then you just give me your answer.

In my view, and I've read the papers and I think I have a little more clarification on some things that I didn't fully understand from the papers.

I think there's two options for me.

The first option is to remand the case for a specific period of time to Judge Sontchi to allow him to address what may be some issues that he didn't get a chance to address fully. But I think he has a record to address, and then bring the case back here and make a decision on essentially what would be his enhanced rulings, which would give me a better foundation, and would then move the case to the Court of Appeals on that enhanced set of rulings and review by me.

The second option is to affirm, and

I think bankruptcy lawyers who have been before me before have heard this, affirm, but without -- in other words, I think this is a close case, but I could affirm the case without further cluttering the record by adding my two cents where I might refine some issues that have been raised.

But, in essence, it would be an affirmance and just send it on to the Court of Appeals where they have plenary review of a full record and not cause you to spend anymore time in the District Court.

Because, you know, in the Third Circuit, they will take it up fully in their perspective of what the case is. And they'll even say in opinions, you know, in the first instance, we look to the Bankruptcy Court decisions. I even put that in my decisions of appeal that go there.

So let me ask the appellant: Do you want to spend some time back with Judge Sontchi or do you want to lose here and move on without me cluttering up what I think is a pretty cogent position you've established in front of me, that

you could then establish in front of the Third Circuit and I won't mess it up for you?

MR. WILAMOWSKY: I appreciate very much -- I appreciate your forthrightness about your view in terms -- and I actually read Your Honor's opinion in -- is it IT Group -- where Your Honor has the footnote about Your Honor's view of the appellate position of this Court relative to the Third Circuit.

Not having -- that having been said, given the choice that Your Honor's presented, I think that we would go for -- we would recommend the remand. And the reason we would -- I would do that is, first of all, I really would like to pin down -- frankly, I don't want to say disrespectfully, but I'd like to pin down Judge Sontchi on the question of whether the ruling on the alternative presupposes that there are -- you can come to the same conclusion either way.

We don't think that works here. So you've got to rule one way or the other, we think. Is it a 363 or 365?

We'd like Judge Sontchi to decide that, or maybe he'll come to the same conclusion

that I don't have to decide it, because you get to the same result either way. But at least it will give him a chance to articulate.

Second of all, we think that Judge Sontchi will be very respectful, as he has in the past, of decisions at the Bankruptcy Court level, so that there is a uniformity of jurisprudence at the Bankruptcy Court in Delaware.

And we think that Judge Walrath, Chief Judge Walrath, the chief bankruptcy judge in In Re: Buffets Holdings, which is a very recent decision. It was issued in May and is very relevant, we thought, in terms of expectation of the parties separability. And we thought it was an extremely useful case.

And I think I'd like to have Judge Sontchi have the benefit of reviewing his colleague's case in determining what to do with this -- with this matter. So that would be our position, Your Honor.

THE COURT: All right. Thank you.

Mr. Jackson.

MR. JACKSON: I'm inclined to agree, Your Honor, on a remand. I think it would be

beneficial for all involved to allow Judge Sontchi to explain the basis for his ruling.

My only concern, however, is that in light of our judicial estoppel argument, I'd want to be sure that Judge Sontchi is able to address it. We have a really odd situation right now in that if we are right, that it is problematic now, that the result is known of the result of the ruling below.

For the appellants to choose now which horse they're going to take up to the Third Circuit, whether it's 365 or 363, I wouldn't want us to lose the ability to argue that.

And then I guess -- I don't know. I haven't looked into it -- whether that is a matter that Judge Sontchi would be able to address on remand in deciding whether, for example, they had waived an issue on appeal. I don't know that the Bankruptcy Court can decide that.

THE COURT: Well, I think he could say if, you know -- the jurisprudence of procedure is that he could say that I don't think that was before me properly, --

MR. JACKSON: Right.

THE COURT: -- and I'm going to stand on my ruling. And you could certainly argue that and he could adopt that. I believe that that wouldn't prevent the Third Circuit.

MR. JACKSON: From considering the option?

THE COURT: Right.

MR. JACKSON: Okay. That makes sense.

THE COURT: So that's why I'm offering both sides here the opportunity to go back in front of him. In fairness, it's a very complex case --

MR. JACKSON: Agreed, Your Honor.

THE COURT: -- with some complex issues. And to go back before him, so he can feel comfortable that he gave his best judgment, which I'm not sure he got a chance to do.

And I don't think you're really affected in judicial estoppel argument, because I think, you know, my reading of their cases are when they have the view that they ought to, I mean, they'll make findings.

MR. JACKSON: Right.

THE COURT: So I don't know if you're really harmed in that regard. But -- but I would certainly leave it to Judge Sontchi to have the option to say -- the option to say, I did my work, and thank you for the opportunity. And back to you, Farnan.

MR. JACKSON: Yeah. Okay.

With that clarification, I just wanted to make sure that we didn't lose an opportunity on an argument that we had advanced on which actually is not really fully briefed.

I point out this, you know, for example, the requirement that there be reliance or that the party below win, that's an open issue under the case law and we haven't briefed that, for example.

THE COURT: I think it's a close case for a lot of reasons, procedurally and substantively, and I think I'm in between Judge Sontchi and the Third Circuit. And I think that I could reach out and give my views, but I don't think they're of much value, because I think it's really here and there.

So I'm willing to pass the case or I'm willing to send it back, and then give you both a chance and Judge Sontchi a fair chance to address it.

So I think you're a remand person, too.

MR. JACKSON: Yeah. I think I'm a remand person. Just raising further for the record --

THE COURT: And I think it saves you time and money --

MR. JACKSON: Right.

THE COURT: -- which is -- you know, we used to do -- you're all so young. You probably weren't around in those days. Only Mr. Brady was.

Only kidding.

MR. WILAMOWSKY: I was around. I was before Your Honor in the Planet Hollywood case.

THE COURT: I'm trying to be respectful. And, you know, we were more intimately involved, and I did learn a lot about bankruptcy and about the procedures.

And, you know, it's just my judgment in this case, I've been as candid as I think I'm allowed to be of where your best shot is. And I think efficiency is always important in bankruptcy, both of clients' funds, lawyers' time, and also trying to get as best an answer.

Because I think, like even if the patents -- there's never sometimes a right answer, but you know, there is a better answer.

MR. JACKSON: All right. So just to clarify, Your Honor, what you're proposing is an order remanding for clarification for the basis of the decision, and then it will come back to you?

THE COURT: Here's how I would do it. I would today enter an order saying this matter -- after oral argument, this matter is remanded back to the Bankruptcy Court for consideration on the issues raised on appeal.

MR. WILAMOWSKY: Raised on appeal.

THE COURT: And I think that gives you both a real broad opportunity to go back in front of Judge Sontchi. I think there will be some further briefing.

For instance, on a couple of issues that I picked up on your papers that both sides would probably want to brief, he'll get a chance to answer. And I think, you know, he's going to be interested in the issues, because I think they're significant.

And then, you know, maybe he'll have the last word or maybe it will come back through. If it comes back through, it will still be my appeal, but at that point you've got a very good likelihood of me passing you through, unless I think he's just, which I don't think will happen unless, you know, he just missed something altogether that somebody can clearly point out.

And then I think you've been efficient for your clients, both the estate and your client, and then you're in the Third Circuit.

MR. JACKSON: Okay. Understood, Your Honor.

THE COURT: Is that --

MR. WILAMOWSKY: That's fine.

THE COURT: Is there anything I could add to all that?

MR. WILAMOWSKY: No, that's fine, Your Honor. I mean, I'm obviously not getting a reversal today, so that sounds like a fair -- short of that, that's -- you know, that's fair. That's certainly fair.

THE COURT: Okay. So --

MR. JACKSON: And just one other clarification, so we don't have to ask you about it later is I presume if Judge Sontchi reconsiders the issue, then if it comes back -- if and when it comes back to Your Honor, the bankruptcy -- I assume the Bankruptcy Court would decide what manner and level of briefing there would be before it came back up to you, because this isn't a today issue that we would have to hammer this out.

THE COURT: Right. It's an issue for the Bankruptcy Court. And that will be in the transcript so that's clear.

MR. WILAMOWSKY: We'll order the transcript.

THE COURT: Exactly. So I agree with you. I'm going to enter a very straight forward one-page order that basically says it's

being sent back for remand on consideration issues raised on appeal.

And, yeah, and then if there is an appeal taken from any reconsideration or action Judge Sontchi takes on the appeal, it should be docketed in this Court as a case to be assigned to me.

Since I'm -- and then you should get in touch with chambers right away, so we can move you. I'll take a quick look and then you don't have to go through mediation or anything.

We'll move you quickly.

MR. WILAMOWSKY: Okay.

THE COURT: So that's all clear.

Okay. All right.

Thank you very much. You were very helpful.

MR. WILAMOWSKY: Thank you, Your Honor.

MR. JACKSON: Thank you, Your Honor.

THE CLERK: All rise.

(Court was recessed at 12:35 p.m.)

State of Delaware)
)
New Castle County)

CERTIFICATE OF REPORTER

I, Heather M. Triozzi, Registered Professional Reporter, Certified Shorthand Reporter, and Notary Public, do hereby certify that the foregoing record, Pages 1 to 61 inclusive, is a true and accurate transcript of my stenographic notes taken on October 16, 2008, in the above-captioned matter.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 22nd day of October, 2008, at Wilmington.

Heather M. Triozzi, RPR, CSR
Cert. No. 184-PS